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Board of Equalization
Legal Division-MIC: 82

M e m o r a n d u m

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Subject: Herbal Teas

As you know, the subject of herbal teas has been problematic. In analyzing herbal teas, we bump into confusion in our analyses among medicines, supplements, and forms of the product. I have discussed this matter with Mr. Nunes, and he has given me a history lesson on this subject back to the dawn of California's sales tax. As the food exemption developed, glitches occasionally arose in the analysis. We have decided the time has come to remove the glitches and clarify the exemption. First the problem.

Sales of food products for human consumption are exempt from tax under Revenue and Taxation Code section 6359 unless excluded from the exemption by that statute. The exclusions relevant to this discussion are set forth in subdivision (c):

> "For purposes of this section, 'food products' do not include medicines and preparations in liquid, powdered, granular, tablet, capsule, lozenge, and pill form sold as dietary supplements or adjuncts."

That is, the exclusion is for 1) medicines and 2) preparations sold in a listed form as supplements. Under the first exclusion, an item sold as a medicine cannot qualify as a food product and its sale is not exempt under section 6359. This is true even if the item is not sold in liquid, powdered, granular, tablet, capsule, lozenge, or pill form since this limitation applies only to items sold as supplements, not to items sold as medicines. Under the second exclusion, a product otherwise qualifying as a food product does not so qualify if sold as a dietary supplement, ***provided*** the item is sold in one of the listed forms. Regulation 1602 confirms that items sold as medicines are excluded from the definition of food products no matter what the form (Reg. 1602(a)(4)), but items sold as supplements are excluded ***only*** if sold in liquid, powdered, granular, tablet, capsule, lozenge, or pill form. (Reg. 1602(a)(5).)

There are two errors in analysis that seem to have been introduced. One does not appear to have had a substantive effect, but it does add to the confusion. We have several annotations which use a supplement analysis referring to one of the listed forms, and then throw in the term

"medical," such as: the product, although in one of the listed forms, does not make medical or supplement claims. It is true that such a product would not be excluded from the definition of food product either as a medicine or as a supplement, but the language of the annotations could confuse some to think that an item making medical claims is excluded from the definition of food product only if sold in one of the listed forms. This would be incorrect.

The other error is that the supplement exclusion has sometimes been applied even to otherwise qualifying food products that are ***not*** in one of the listed forms. The correct rule is that if a product otherwise qualifying as a food product is not in one of the listed forms, the product does not come with the supplement exclusion ***even if*** sold as a supplement.

This issue repeatedly arises in the case of herbal teas. Such teas may be sold in cut leaf form, or may be sold in one of the forms listed above (e.g., powdered or capsule). If the tea is sold in cut leaf form and would otherwise qualify as a food product for purposes of the exemption, the only basis for excluding it from that definition is if it makes medicinal claims since the medicinal exclusion applies regardless of the form of the product. Thus, when determining the application of tax to sales of herbal teas in the form of cut leaf herbs, we examine the label and marketing brochures for medicinal claims. If they exist, the tea is a medicine and its sale is taxable (assuming it does not qualify for the prescription medicine exemption). If neither the label nor the marketing brochures make medicinal claims, the sale of that product is not excluded from the definition of food product under the supplement exclusion without regard to any supplement claims.

When the tea is sold in one of the listed forms, we look to the labels and marketing brochures for both medicinal claims and supplement claims. If the product is sold as a medicine, unless qualifying for the prescription medicine exemption, its sale is taxable (i.e., the same analysis as above - the form is irrelevant if the product is sold as a medicine). If the product is sold as a supplement, it is excluded from the definition of food product because it meets both conditions to the supplement exclusion: 1) sold as a supplement; and 2) sold in one of the listed forms.

Future annotations published on the subject of supplements need to either identify the form of the product under review (e.g., "ABC is sold in pill form and ...") or identify the distinction discussed herein. Future annotations should not talk about "medicines" in the same breath as supplements for the reasons discussed above. Below I set forth language for a new annotation that discusses the subject of this memorandum and will, hopefully, serve to clarify these issues. With the help of Mr. Nunes, I have identified some of the current annotations that suffer the infirmities discussed herein.

<u>245.1090 (3/4/71)</u> This annotation combines medical claims and supplement claims as if they are both treated the same. This could be read to mean that a product is excluded from the definition of food products as a medicine only if in one of the listed forms. Since the annotation does not mention the listed forms at all, it could also be read to mean that a product can be

disqualified from the definition of food product as a supplement even if not in one of the listed forms. It is misleading for both these reasons and should be deleted.

245.1091 (8/9/72) This annotation suffers the same infirmities as 245.1090 and should be deleted.

245.1125 (4/24/72) This annotation concludes that a product is excluded as a supplement with no discussion of the form of the product. Unless the product were sold in one of the listed forms, it cannot be excluded from the definition of food product as a supplement. In fact, this product was a caramel candy, which is not one of the listed forms. The annotation should be deleted.

245.1160 (8/11/65) This annotation lacks the necessary facts to reach its conclusion. Although the term "wafer" could be used to describe one of the listed forms (e.g., a tablet), it appears likely that this product is a wafer in the sense of a cookie or a piece of candy, neither of which is in one of the listed forms. Thus, the product does not appear to be excludable from the definition of a food product based on the supplement exclusion. Although it is possible that the product might be excluded from the food products exemption based on the medicine exclusion, there are insufficient facts to make this determination. Since the annotation lacks the correct analysis and the necessary facts to perform the correct analysis, it should be deleted.

245.1209 (12/11/90) Although the conclusion is correct that these products do not qualify as food products, it introduces a superfluous discussion of supplements and the form of the product in the context of the medicine exclusion. The annotation cannot be salvaged and should be deleted.

245.1260 (3/12/70) This annotation does not disclose the form of one of the products, so it is not clear whether such product would be excluded from the food product exemption as a supplement. The backup is of no help except to disclose another misleading comment in the annotation. The backup indicates that the products would be regarded as taxable after a certain date because of that particular taxpayer's reliance on previous advice. It does *not* indicate that the sale of the products themselves would become taxable effective on that date. That is, the annotation incorrectly implies that there was a change in the law or regulation as of that date. (An annotation should never include an effective date based on section 6596 reliance unless the annotation is on the subject of section 6596 reliance and the date is necessary to the understanding of the annotation.) The annotation should be deleted.

245.1300 (5/21/91) This annotation combines medicines with a discussion of being sold in one of the listed forms. Since it indicates the wrong analysis, it should be deleted.

245.1347 (11/21/94) This annotation indicates that products labeled as supplements or which say to "take with meals" are excluded from the definition of food products. There is no discussion of the form of the products. It is possible that some or all of the products in question were not in one of the listed forms and would not be excluded from the definition of food product.

Since the backup correspondence does not include the missing information, the annotation cannot be fixed and should be deleted.

245.1350 (12/5/90) This is another annotation on herbs that mixes the concepts of medicines and supplements, and therefore should be deleted.

Annotation 245.1420, which covers items qualifying as food products, includes the reference "Wheat Germ 9/18/52." Annotation 245.1440, which covers items not qualifying as food products, includes the reference "Wheat Germ 7/1/72." Together, these references lead me to the question, what? These references conflict and neither is correct. That is, wheat germ may or may not qualify as a food product depending on how it is sold. Both references should be deleted. Annotation 245.1440 also includes the reference "Wheat Germ Perles (See Exempt List) 1/5/53." This suffers the same infirmity as the references to just "wheat germ." Furthermore, its reference to "(See Exempt List)" is confusing. The annotation also includes the reference "Wheat Germ Oil (See Exempt List) 7/1/72." The regulation says that wheat germ oil is regarded as a supplement. Its inclusion in annotation 245.1440 with the note to see the exempt list is simply confusing. All the references discussed in this paragraph should be deleted.

There are likely other annotations that need to be modified or deleted for the reasons discussed above. We can work on this as appropriate. Please annotate the rules discussed herein as follows:

> When an item is sold as a medicine, it does not qualify as a food product. Thus, the sale of an item as a medicine is subject to tax unless qualifying for the prescription medicine exemption explained in Regulation 1591. Whether a product is sold as a medicine is determined based on the label on the product as well as product literature that may be given to purchasers and potential purchasers in order to market it as a medicine. For example, a label containing detailed cautionary instructions might indicate that the product is being marketed as having medicinal qualities. If specific medicinal claims are made in any of the product literature, sales of the product are not exempt from tax as food products.
>
> If a product otherwise qualifying as a food product is not sold as a medicine, then the form in which it is sold is relevant to determine if it is excluded from the definition of food product as a supplement. A product does not qualify as a food product if it is sold in liquid, powdered, granular, tablet, capsule, lozenge, or pill form if either: 1) the product is described as a food supplement, food adjunct, dietary supplement, or dietary adjunct on its labels or packaging, or 2) the product is prescribed or designed to remedy a specific dietary deficiency or to increase or decrease generally the intake of vitamins, protein, minerals, or calories.
>
> If a product is not sold in liquid, powdered, granular, tablet, capsule, lozenge, or pill form, the supplement exclusion is *not* relevant. For example, an

herbal tea that would otherwise qualify as a food product and which is sold in cut leaf form is not a supplement excluded from the definition of "food product" without regard to the manner in which it is sold. Assuming no medicinal claims are made with respect to that cut leaf herb tea, it is a food product and its sale is exempt from tax (without regard to whether its label makes "supplement" claims). If that same product is sold in one of the listed forms such as powdered or capsule, however, further analysis is required.

If the label or other product literature accompanying the package containing a product in one of the listed forms makes supplement claims, the product does not qualify as a food product and its sales are subject to tax. While the presence of instructions on a product label regarding when to take the product in relation to meals is an indicator that the product is meant as a supplement to meals, the total circumstances must be considered. For example, in the case of teas, an instruction to "take with meals" does not in itself cause a tea product to be considered a food supplement. Teas are customarily consumed with meals, as well as before or after meals. It should also be noted that the fact that a tea in one of the listed forms is vitamin fortified does not alone mean that it is excluded from the definition of food product as a supplement.

A product in one of the listed forms will also fail to qualify as a food product if the product is prescribed or designed to remedy a specific dietary deficiency or to increase or decrease generally the intake of vitamins, protein, minerals, or calories. Similar to the determination of whether a product is sold as a medicine, the product label, packaging, and brochures and other product literature that may be given to purchasers and potential purchasers help determine whether a product is prescribed or designed for these purposes. Subdivision (a)(5) of Regulation 1602 sets forth other considerations used to determine if a product will be regarded as prescribed or designed for these purposes without regard to whether there are any such claims on product literature.

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